Q1 2016 Fortunato Asset Management Newsletter

Around the Market

It seems only a few weeks ago, investors were obsessed with a collapsing stock market to begin 2016 and watching an almost daily fall in crude oil prices with intense interest. Increasing forecasts that an anemic global economy would soon put the U.S. into its own recession were also prevalent. It is amazing how fast perceptions and sentiment can change, and change they did as we've had an incredible bounce back rally from February 11th to now. But I believe sentiment will turn back to negative again before the year is out.

So where does that leave the U.S. economy? It likely means the U.S. is in for another muddle through year of two percent GDP growth. This has been the hallmark in what continues to be by far the weakest post war recovery on record despite massive stimulus programs in 2009, continued near zero bound interest rate policy, and a quintupling of the Federal Reserve's balance sheet.

Given this backdrop, where does that leave investors? With markets trading at expensive valuations by many important metrics such as price/sales, Market Cap to GDP, and Schiller P/E, it is important to keep an ample cash allocation, and take the pain of patience. On that note, following is an interesting excerpt from Berkshire Hathaway Co-Chairman Charlie Munger at the Daily Journal annual meeting last month:

"A few good decisions over a long period of time can lead to great success. You make your money by the waiting. A fair amount of patience is required. Like when we had all this money flowing in from the foreclosure boom, and we deployed it in a day. It wasn't luck we had the money on hand.

I think this is one of the most underappreciated notions in investing. We all agree that patience is very important, but how many of us actually have the capacity to suffer from short-term pains of inactivity and capitulate to the deprival super-reaction syndrome? Technology surely makes things worse by conditioning our brain to react to every single distraction caused by text message, email or just a website, so we are less capable of delaying gratification but more addicted to instant rewards. My view is that those who can practice delayed gratification will have a temperament edge in investing within their age cohort."

So while we wait for better than average opportunities, we keep up the search for under-valued or under-appreciated companies perhaps in sectors that are beaten down. For example we were fortunate in Fortunato 1 accounts to pick up a couple of energy companies when the oil per barrel price hit $25.50. That price only lasted a day, and those stocks are up considerably 35% to 55% as crude oil prices rebounded.

Market Performance

I recently ran across the following comment in a noted hedge funds (Pabrai Funds) annual report which I thought shed an appropriate light on the stealth bear market of 2015 in which the average stock was down 24%.

"In 2015 the top ten stocks in the S&P 500 by market cap were up nearly 23%, while the remaining 490 fell 3.5% on average. And since the S&P is market cap weighted, the top ten stocks make up nearly a fifth of the index. There were very few places to hide. It was very hard not to have a down year in 2015 – and most mutual funds and hedge funds encountered stiff headwinds in 2015."

The Best Part
A Stock We Like

Every quarter I highlight a company or two that we like with a few notes on the reasons. This quarter I'm highlighting **Ubiquiti Networks (Nasdaq: UBNT)**.

Having run a couple of technology companies, one of the traits I look for when investing in one is great management with a dual focus on industry disruption and the bottom line. Many technology company managements tend to have spendthrift propensities that are just plain offensive to me. They throw billions of dollars at new unproven projects, acquire companies for soaring valuations, and award lush employee stock options. Such shameful practices are not present at Ubiquiti Networks and the reason is simple. The companies largest shareholder is it's founder and CEO Robert Pera who owns ~65% of the shares outstanding. His interests are aligned with other shareholders.

The company produces a wide range of products in the outdoor wireless antennas, enterprise wifi devices, video surveillance, and switching markets to name a few. Products are distributed through wholesalers around the world, which avoids the high cost of a sales and marketing staff. Ubiquiti products are disruptive due to their low cost and high performance standards. They usually sell for 30% of the price of a similar product from a competitor like Cisco.

Another of the reasons I like the stock is that they have kept growing and expanding margins slightly even with major currency headwinds over the past year. Those currency translation headwinds are likely behind us now so growth comparisons should look strong this year. The company is extremely innovative, not only with their products but also how they go about selling them. There are usually around 700 community members on the forum boards at any given time and evangelism about their products products are one of the main marketing tools. The company bought back around 3.3% of the shares outstanding in 2015, there is negligible debt and returns on invested capital can be huge."The best product will win out," states the CEO Robert Pera. He believes it and sets forth producing it at a fraction of the cost of the competition. The stock is neither cheap nor expensive at today's valuation.

Our 3 Strategies

Fortunato 1 Growth and Value Strategy. Invests in 12 to 20 stocks, a combination of growth and value stocks.
Fortunato 2 Concentrated Value Strategy. Invests in a concentrated portfolio of value stocks usually between 5 and 10.
Fortunato 3 Dividend and Income Strategy. Invests in dividend stocks, preferred stock and bonds.

Fees, Costs and Alignment

The three fund strategies have a low expense structure and I consider it a competitive advantage. FAM pays all its own operational costs including audit, legal, accounting, administration, tax and filing fees. None are passed on to investors. Below is a recap of the fee structure for qualified investors:

Fortunato 1 – No Management Fee, Performance Fee is 25% over a 6% annual return. On the first 6%, no fee.
Fortunato 2 - No Management Fee, Performance Fee is 20% over a 4% annual return. On the first 4%, no fee.
Fortunato 3 - .75% on the investment.

There are two components to beating the market indices. The first is to have low frictional costs (ie low fees and costs). And the second is to generate superior returns. Low frictional costs will assist in superior long term performance.

My family has a substantial percentage of our assets in the three Fortunato Asset Management strategies. I am bullish on the long-term future of Fortunato and plan on managing fund strategies as long as I am able. Our interests are completely aligned.

Final Thoughts

Thank you for investing with Fortunato. It's a pleasure to serve you. Though I have no idea what market valuations hold for us in the future, I do know one thing. There will be excellent opportunities to invest in great companies.

If you should need a consultation on investment related activities, please do not hesitate to ask.